<u>State of Colorado Health Savings Account (HSA) Program</u>
<u>Questions & Answers</u>

1. **Q. What health plan do I need to participate in the State's HSA?**
   A. To participate in the State's HSA, you must enroll in the PPO-H health plan. This plan is the only HSA-qualified plan offered by the State. You cannot be enrolled in another plan with the State or covered as dependent under another's plan (e.g., a spouse's plan).

2. **Q. Why does the State's HSA-qualified plan have such low deductibles when the federal government allows higher amounts for such plans?**
   A. The State chose the *minimum* amounts allowed by the federal government for the deductibles in the PPO-H plan, $1000 for employee only and $2000 for employee plus spouse/child(ren). There were a few reasons we did this. First, we wanted to make the PPO-H plan an attractive option in its own right, with or without the HSA. We tried to strike a balance between premiums, deductibles and services covered so that employees would feel it was a useful and worthwhile plan. While there has been much written and said about HSAs, the State was unsure of the actual interest of employees to enroll in HSAs. We believed it was better to err on the side of caution by going with the lower deductibles allowed. Certainly, the level of participation in the program and employees' comments will be considered in future years.

3. **Q. Who will be the "bookkeeper" for my HSA?**
   A. **You.** While the State will take a post-tax payroll deduction for your contribution, and Mellon Financial is the custodian, it is your responsibility to keep track of your deposits and expenditures and keep all of your receipts (necessary if you are audited by the IRS). It is also your responsibility to adhere to the regulations governing HSAs and payment of qualified medical expenses. The consequences for not doing so will come from the IRS.

4. **Q. Can I use my HSA to pay for medical expenses incurred before I set up my account?**
   A. No. You cannot reimburse qualified medical expenses incurred before your account is established, which for most State employees, will be several days after the first payroll runs in the new plan year, FY06.

5. **Q. What happens once I enroll in an HSA (and the PPO-H with HSA plan) in the online enrollment system?**
   A. Once your enrollment has been transmitted to Great-West Healthcare at the conclusion of open enrollment, Great-West will pass your information along to Mellon Financial, the custodian of the HSAs for the State's program. **Mellon will then send you a welcome kit that includes a signature card and beneficiary designation form that you must sign and return before your HSA will be set up.**

After you return the signature card you will receive a checkbook and debit card. You **are not** to use these until your first monthly contribution has been credited to your account. For most State employees, this will be several days after the first payroll deduction of the new plan year.

The one-time $10.00 set up fee will be withdrawn immediately from your first monthly contribution. A $3.50 monthly service fee will be withdrawn from the account itself each month at the time each contribution is credited to your account.

6. **Q. What happens if I spend more than I have in the account?**
   A. Regarding checks, there will be no overdraft protection and you will be charged $25 for each overdraft. If you try to use your debit card for an expense that exceeds the available balance, your card will simply be declined at the time of purchase.

7. **Q. Is my premium for the PPO-H health plan and my contribution to the State's HSA the same?**
   A. **No.** The **premium** for your PPO-H plan is **separate** from your **HSA contribution** (for premiums, please see the medical plans rate chart for FY06 on the benefits website **www.colorado.gov/dpa/dhr/benefits**). This premium is the cost of that particular health plan, just like the other premiums for the other health plans. You can choose to have this premium deducted from your pay pre-tax or post-tax, just like you can with any of the health plans.

   Your HSA contribution is a separate, post-tax contribution that you make to this type of savings account. It is money that you are setting aside for medical expenses. Your **monthly** contribution to the HSA must be at least $25, but cannot exceed $83.32 for employee only coverage or $166.66 for employee plus any dependents coverage.

8. **Q. Can I contribute more than the monthly maximums of either $83.32 (employee only) or $166.66 (employee plus any dependents) in any month so long as I do not exceed the total annual deductible amounts of $1000 (employee only) or $2000 (employee plus dependents)? For example, could I contribute all of the deductible up front in one or two contributions only?**
   A. No. Federal rules prohibit contributing more than 1/12th of the HSA-qualified plan deductible for any month in which you are enrolled in an HSA-qualified plan. Eligibility for an HSA is a month-to-month verification, meaning an individual is eligible to contribute to the State's HSA only if on the first of every month, the individual is:
   - Covered by the PPO-H with HSA plan.
   - Not covered by another health plan (e.g., a spouse's plan)
   - Ineligible to be claimed as a dependent on another's tax return; and
   - Not enrolled in Medicare.

This also means that newly hired employees who elect to participate in the HSA cannot contribute the full $1000 or $2000 deductible amounts for whatever portion of the plan year remains. They are still limited to contributing $83.32 or $166.66 per month.

9. **Q. Can I ever contribute more than the $1000 (employee only) or $2000 (employee plus dependents) annual deductible amounts for the PPO-H plan?**

   A. HSA enrollees age 55 or older may deposit additional funds directly to Mellon Financial. For the State's HSA program, the maximum "catch-up" contribution is $300 for 2005 (a six-month prorated amount of the $600 allowed by the federal government for the 2005 tax/calendar year – the State will only offer the HSA-qualified health plan, the PPO-H, for 6 months of 2005). **Otherwise, you CANNOT contribute more than the deductible amounts.** The State's mechanism for controlling this is through limiting monthly payroll deductions to 1/12th of the PPO-H deductible amounts. If, however, you make a contribution directly to Mellon Financial, e.g., with a personal check, there is no mechanism in place to stop you. Mellon will only monitor accounts to ensure they do not exceed the federally allowable amount for HSA-qualified health plan deductibles ($2650 for employee only, $5250 employee plus dependents). Remember, the State chose the *minimum* allowed deductibles for these plans (see # 2 above)

   Thus, it is *possible* to contribute more than the deductibles for the PPO-H plan, but it is **illegal**. Doing so will mean that you are subject to IRS penalties**. It is your responsibility to keep track of your contributions and expenditures and keep all of your receipts (necessary if you are audited by the IRS)**. **It is also your responsibility to adhere to the regulations governing HSAs and payment of qualified medical expenses.**

10. **Q. What happens if I don't use the money in my HSA for a medical expense?**

    A. If the money is used for other than qualified medical expenses, **the expenditure will be taxed and**, for individuals who are not disabled or over age 65, **subject to a 10% tax penalty**. **It is your responsibility to report this information on your income taxes.**

11. **Q. How do I know what is included as "qualified medical expenses?"**

    A. HSA funds can pay for any "qualified medical expense," even if the expense is not covered by the HSA-qualified health plan, PPO-H. Unfortunately, we cannot provide a definitive list of "qualified medical expenses." A partial list is provided in IRS publication 502 (available on the benefits site), **www.colorado.gov/dpa/dhr/benefits/hsa06.htm** and also at **www.irs.gov**). There have been thousands of cases involving the many nuances of what constitutes "medical care" for purposes of section 213(d) of the Internal Revenue Code. A determination of whether an expense is "medical care" is based on all the relevant facts and circumstances. To be an expense for medical care, the expense has to be primarily for the prevention or alleviation of a physical or mental defect or illness. The determination often hangs on the word "primarily."

12. **Q. Who decides whether the money I'm spending from my HSA is for "qualified medical expense?"**

A. You are responsible for that decision, and therefore should familiarize yourself with what qualified medical expenses are(at least as partially defined in IRS publication 502, mentioned above in # 10) and also keep your receipts in case you need to defend your expenditures or decisions during an audit.

13. Q. Can I have an HSA and a health care flexible spending account (FSA) at the same time?

A. **No**. The State will not permit employees to participate in both the State's HSA and the State's traditional health care FSA since the latter is not a HSA-qualified health plan. Although an employer may set up a restricted health care FSA to cover expenses not covered by the HSA-qualified plan, the State does not offer such a limited health care FSA.

The individual participant, who is responsible for monitoring contributions and distributions in accordance with the IRS regulations, *owns* an HSA. If audited and found to be in non-compliance, the participant is the sole person or entity responsible for any penalties from the IRS. In contrast, the sponsor of a health care FSA, such as the State, is *required by law* to adjudicate the claims in accordance with the plan document and applicable Treasury regulations. Misuse of an FSA can jeopardize the tax-qualified status of the entire program. The State cannot let the program be jeopardized in this way.

14. Q. Can I direct the investments for my HSA?

A. Not until the balance exceeds $4500. Until that point, the money is in a "transactional account," not unlike a standard checking account, earning a minimal **.75%** interest rate. Upon reaching $4500, the money in excess of this amount will go into a mutual fund account, whereby the participant can choose from Mellon Financial's lineup of funds. The first $4500, though, remains in the transactional account, still earning **.75%**. Truly, the HSA is primarily a tax-savings tool and only minimally an investment vehicle.

If you are interested in maximizing your investment dollars and directing your investments, you may wish to consider the State's **457 Deferred Compensation Plan**. It offers a wide variety of professionally managed investment options, ranging from conservative to aggressive in risk / return potential. You may choose a pre-assembled Profile Portfolio (conservative, moderate, or aggressive) with the 457 Plan. For more information, contact Great-West Retirement Services at **1.800.838.0457** or online at **www.colorado457.com** . You can also view information about the 457 Plan on the benefits website, **www.colorado.gov/dpa/dhr/benefits/retire06.htm**. (Note: Great-West Retirement Services is distinct from Great-West Healthcare, who administers the self-funded health plans for the State, including the PPO-H.)

15. Q. Do unused funds in an HSA roll over year after year?

A. Yes. The unused balance in an HSA automatically rolls over year after year. You won't lose your money if you don't spend it within the plan year.

16. **Q. What happens to the money in my HSA if I lose my HSA-qualified health plan coverage? Can I still use the money that is already in the HSA for medical expenses tax-free?**

A. Once funds are deposited into the HSA, the account can be used to pay for qualified medical expenses tax-free, even if you no longer have HSA-qualified health plan coverage. There is no time limit on using the funds and they roll over automatically each year, remaining there indefinitely until used.

However, you are NOT allowed to contribute to your HSA if you are not covered by an HSA-qualified health plan. If you regain such coverage at a later date, you may begin making contributions to your HSA again.

17. **Q. Can I monitor my account? How?**

A. Yes, you will be able to monitor your account online through Mellon Financial's website. The exact website and security procedures will be provided to you via the welcome kit you will receive from Mellon (see # 5 above).

18. **Q. Are dental and vision care qualified expenses under an HSA?**

A. Yes, as long as these are qualified medical expenses (see # 10). Cosmetic procedures (a common exclusion in health and dental plans) are not qualified medical expenses.

19. **Q. Can I use the money in my HSA to pay for medical care for a family member? What if I am the only person in my family covered by the HSA-qualified health plan and the rest of my family is covered by another type of health plan?**

A. You may withdraw funds to pay for the qualified medical expenses of yourself, your spouse or a dependent without tax penalty. It is not necessary for all members of your family to be covered by the HSA-qualified health plan.

20. **Q. Can I use my HSA to pay for medical service provided in other countries?**

A. Yes, if the expenses are qualified medical expenses. (See # 10)

21. **Q. Can I pay my health insurance premiums with an HSA?**

A. In most cases, no. You can only use your HSA to pay health insurance premiums if you are collecting federal or state unemployment benefits, or you have COBRA continuation coverage through a former employer.

22. **Q. What happens to the money in an HSA after you turn age 65?**

A. You can continue to use your account tax-free for out-of-pocket health expenses. When you enroll in Medicare, you can use your account to pay Medicare premiums, deductibles, co-pays, and coinsurance under any part of Medicare. If you have retiree health benefits through your former employer, you can also use your account to pay for your share of retiree medical insurance premiums. **The one expense you cannot use**

your account for is to purchase a Medicare supplemental insurance, or "Medigap," policy.

Once you turn 65, you can also use your account to pay for things other than medical expenses. If used for other expenses, the amount withdrawn will be taxable as income but will not be subject to any other penalties. **Individuals under age 65 who use their accounts for non-medical expenses must pay income tax and a 10% penalty on the amount withdrawn (see #9 above).**

23. Q. How do I use my HSA to pay my physician when I am at the physician's office?

A. If you are still covered by your HSA-qualified health plan and you have not met your policy deductible, your physician may ask you to pay for the services provided before you leave the office. If the physician is an in-network provider, there will probably be a discounted price for services that the physician and the insurance company have agreed upon. If your HSA custodian has provided you with a checkbook and/or debit card (as the Mellon Financial will for participants in the State's HSA), you can pay your physician directly from the account.

If your physician does not ask for payment at the time of service, then he or she will probably submit a claim to your insurance company, and the insurance company will apply any discounts based on their contract with the physician. You should then receive an "Explanation of Benefits" (EOB) from your insurance plan stating how much the negotiated payment amount is, and that you are responsible for 100% of this negotiated amount. If you have not already made payment to the physician for the services provided, the physician may then send you a bill for payment.

24. Q. How much information can Great-West Healthcare provide on the HSAs?

A. During open enrollment, all the HSA tools are available for Great-West Healthcare representatives to discuss the PPO-H with HSA plan with State employees.